

# The Canadian Chartered Accountant

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## COMMENT AND OPINION

"Neither snow nor rain nor heat nor strikes nor gloom of night  
stays these couriers from the swift completion of their appointed  
rounds" (*with apologies*)

THE 48th annual meeting at Charlotte town was one that will be remembered for a long time by all who were present. The beauty and the hospitality of "The Island" would, in any event, have warranted such an opening sentence, but this year the Islanders were not such a power unto themselves as they are usually — they allowed their pleasurable existence to be overborne by outside influences — not only from the mainland, that place of fierce competition, tourists and financiers, but also from the ocean which has usually been a friendly one and allowed ready access to and departure from the Island to those with its interests at heart. As a matter of fact, a few of us were piped on to the Pictou Ferry in Nova Scotia to the strains of "Will ye no' come back again?". The weather was calm and the sun was shining, but these Nova Scotians knew what they were about. We were no sooner on the Island when the heavens opened and the rains descended. The winds blew and we were hurricane-bound for a day and a half. Several hardy souls ventured from the comfortable and well-equipped and well-staffed hotel during the blow but returned drenched to their skins to the rude comments of those who remained under shelter.

Succeeding days were different, however. The sun shone and everything about took on a wondrous hue, but the well-equipped and well-staffed hotel was neither equipped nor staffed. Strike pickets took up their places outside and told us what we have always hoped for "We want a 40 hour week". For the balance of our stay, we made beds, washed out bathtubs and from time to time descended to the depths to obtain ice. For \$1.00 a day, the allowance made to us by the hotel, we not only took care of our own living quarters but moved chairs, emptied ashtrays and dusted up the meeting rooms. We must say that the rate of pay did seem to us to be somewhat low; we presume, however, that there might be some answer on the score of efficiency or on sending boys to do a man's errand. Therefore, we have made no formal complaint, but take this opportunity to let the hotel's management know that this should not be taken as a precedent. Our *per diem* rates of pay should not be confused with those for freight cars.

But there are advantages in living in what might be described as a large tourist cabin. Most of those of us from Quebec City and west of it were housed in the hotel where few other guests re-

maintained. Doors were left open and the greatest camaraderie developed.

However, our kindly hosts of the Prince Edward Island Institute did not allow us to become bored by our own company. Prompt and efficient arrangements were made to move from the hotel those social functions which were to have been held there, and those other occasions, which had been arranged originally at beaches and other places, were carried through as scheduled.

The greatest credit is due to the host committees for their adeptness in carrying on under adverse circumstances. Detailed plans which had been laid for months were completely upset and new ones made and executed at the last moment. The teamwork was excellent and it seemed as if Mr. Manning and his associates had not a care in the world.

Details of the Executive Committee, Council, and technical sessions, and of the programme of social events will be found in succeeding issues of this journal and in the annual publication of the White Book. These notes are to be taken as a tribute to our hosts. We shall long recall their munificent hospitality — and those lobsters!

### Accountants Really Are Human

**I**S the accountant human or machine? We concede that up to this point the controversy would appear to have gone by default to those on the side of the machine, and no doubt any contrary opinion expressed by us on the matter will be discounted as coming from an interested party. Perhaps, however, we can document our opinion and confound our opponents.

One thing that has always impressed us at gatherings of accountants, such as the late annual meeting at Charlotte-

town, is that those who attend are invariably representative in character, appearance, manner, and opinion of the particular part of Canada from which they come. Thus we know some staid and conservative Toronto accountants (graduates even of Upper Canada College!) who, transported by the exigencies of the profession to the West Coast, have acquired a care-free spirit and ebullience of manner (sometimes of dress) which is rare in the environs of Queen's Park.

Our Quebec accountants, no doubt because of the French influence, display a certain elegance in appearance and manner. The Saskatchewan representatives have that kindliness and camaraderie which seems to be inseparable from those who dwell in the heart of the great plains. Manitoban accountants are, as all Manitobans always are, gracious and good-humoured, men who, it is easy to see are not at all impressed by adversity. There was one Calgary accountant present who we were quite sure would at any time make a sudden appearance in a ten gallon hat with a six gun at his side. Accountants from Newfoundland and the Maritimes, where one is always close to the forest and the sea and not so subject to the baneful influence of the great modern metropolis, seemed to us to display an easy attitude and a deeper appreciation of simplicity.

In their approach to the business of the meeting it seemed to us, too, that the representatives of each Institute took a line characteristic of their particular Province. Provincial delegates from Ontario to the Pacific, it seemed to us, viewed the problems of the profession purely pragmatically. The Quebec delegates, we thought, were more influenced by logic and reason, and the Maritime Institutes were somewhere between the two.



*Photo by Frank Halliday, Calgary*

**MR. KENNETH J. MORRISON, O.B.E., F.C.A.**  
*President of the Dominion Association of Chartered Accountants, 1950-51*





What impressed us most forcibly of all was the overwhelming desire by representatives of ten independent Institutes to sink whatever differences of opinion might arise, and to find a basis for co-operation. That strikes us as a Canadian characteristic very definitely, but, more than that, an essentially human quality.

Do we make our point?

### Survey of Profession

**T**URNING to the more serious side and looking at the decisions and plans for future action arrived at, there is no doubt that it was a most successful meeting. There will as a result be developments in our educational programme, the D.A.C.A. office will be expanded and its usefulness increased, greater attention will be given to public relations, and last, but by no means least, a survey will be conducted to determine whether chartered accountants are fully serving the public interest, and if not, what can be done to ensure that we do so.

This last decision is the direct consequence of a development which has been growing since the termination of hostilities, namely the continuous increase in the demand for skilled accounting services. Behind this, of course, is the rapid rise in taxation rates in recent years together with the complex evolutions of the tax law, the increasing awareness by the business community of the accountant's role, and the steady encroachment of government into so many fields, creating its own demand for ac-

countants and imposing that need upon others.

Our own Association has in consequence, and in spite of high admission standards, grown by leaps and bounds. There are today in this Dominion upwards of 4000 chartered accountants and almost that many students-in-accounts. A decade ago chartered accountants numbered 2300 and students were proportionately even fewer.

More significant, perhaps, than the growth in our own membership has been the apparently even greater growth in the number of others, some well qualified, others not, who hold themselves out to the public as accountants, auditors, tax consultants and the like. Clearly, the requirements of the public for skilled accountants must be met, whether by our members or by others, and certainly we lay no claim to a privileged position. However, as qualified accountants whose professional lives are devoted to skilled, informed and honest financial reporting, we are concerned, and very properly so, that those, whether ourselves or others, who offer accounting services to the public are competent to do so. If they are, we welcome them to the profession; if not we conceive it our duty to bring that fact to the attention of those upon whom it lies to safeguard the public interest.

It is with such considerations as these in mind that the Dominion Association has decided to undertake a survey of the need for accounting services in Canada, which it is hoped will be expedited.

# The Opportunities Of a Chartered Accountant

By Walter W. B. Dick, C.A.

The chartered accountant: what he is,  
what he does, and what he should do

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**WHAT DO** others think of accountants? As students and advocates of accounting we are vitally interested.

An American columnist, Westbrook Pegler, is reported in *The Journal of Accountancy* as having a woman character tell her husband in derision that his mother must have been frightened by a CPA. Fortunately for every one, Elbert Hubbard had the accountant sized up, for he ends his much quoted description with the following: "happily they never reproduce and finally all of them go to Hell".

On the other hand, there are those people who do have a real regard for the chartered accountant. I think fondly, first of all, of those individuals who have the foresight in their organized affairs, to require that their financial transactions be audited by a chartered accountant. Again the chartered accountant's ability in matters of management and finance is attested to by the many advertisements which have appeared recently in such papers as *The Financial Post* and read somewhat as follows, "Chartered accountant wanted, excellent position with progressive manufacturing company for a

man with experience in cost accounting, material and production control, handling of staff and organization ability".

Advertising consultants never miss an opportunity to drive home a fact, and we find in their clients' advertising such statements as, "Methods of dishonesty are many times so involved that it takes a chartered accountant to find them out".

We all know how disturbing it is to be pointed at during a bridge party and have someone say, "He is a chartered accountant, give the score pad to him". (However, when it comes to scoring in golf, I do appreciate the opportunity of working on my own card.)

Seriously, these observations indicate very clearly how well those chartered accountants who have preceded us have engendered the confidence of the people in the services available to society through the chartered accountant. We owe much to the tradition of service established in England, where the chartered accountant is a person of the highest repute who guards jealously his independence and integrity of thought and action. Let us in Canada aim to maintain our affairs on equally as high a plane.

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An address to the Maritime Students' Convention, Saint John, June 2, 1950

### What Manner of Man is a C.A.?

I am certain that chartered accountants cannot be typed by their outward appearance. The fruit of their labour is influenced, among other things, by education, intelligence, interest in work, integrity, knowledge, perseverance and hard work. It is these personal under-the-hat traits that distinguish the chartered accountant. With these characteristics he attained the right to the diploma of accountancy, indicating that he satisfactorily passed the prescribed examinations, and was admitted as a member of his Institute.

### What Does a C.A. Accountant Do?

Generally speaking the chartered accountant's services may be offered in two fields:

- (1) as a public accountant;
- (2) as a skilled and qualified accountant not practising public accounting but engaged in activities to which such qualifications are basic.

As a public accountant, the chartered accountant holds himself out as qualified and available to carry out, among others, any of the following assignments:

- (a) Auditing;
- (b) Tax consulting;
- (c) Management engineering — efficiency reviews;
- (d) Systematizing;
- (e) Cost accounting;
- (f) Financial investigations;
- (g) Financial reorganizations;
- (h) Arbitration;
- (i) Directing effort on economic and social problems;
- (j) Expert testimony—matters related to finance and accounting.

Where the chartered accountant is engaged in fields other than that of public accounting, his education and experience fit him particularly for the role of controller. In such a position he is a very important individual in our economic and social set-up.

Management is a very broad term indicating effort in directing the use of material and personnel resources in providing satisfaction for man's wants. The chartered accountant, in this field, is contributing to better things in no less a degree than those in public accounting.

### The Opportunities for the C.A.

It is generally agreed that it is only through a better understanding of finance by capital, management, and labour that there can be improved social conditions. In spite of the acknowledged improvement in financial statements, it is apparent to everyone that there is still general mistrust of the facts shown therein, particularly regarding profits. Further, the use of such words as "surplus", "reserves" and "depreciation" is confusing because their popular connotation is not necessarily the meaning that the accountant had in mind. One of our provincial governments was somewhat embarrassed recently by the interpretation the public put on the term surplus. Here, then, is an opportunity to serve by helping the average person to understand financial statements and terminology. On the other hand, we should not minimize the complexity of modern finance and endeavour to solicit popularity by trying to put the answers in a nutshell that can sell at 5c.

Many writers on economic and social matters have properly pointed out how much free enterprise, with the profit motive as the driving force, has contributed to the general welfare of society. These people have called upon persons such as the chartered accountant, who is cognizant of the facts, to defend and explain the profit system. It is expected that the chartered accountant will, in his independent position, explain how the return to the various factors in the production of a service or good have been determined and allocated. Chartered account-

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ants' literary and persuasive powers should rise to the occasion and uphold that system which has so much to offer when it is properly understood.

Watson Sellar, auditor general of Canada, demonstrated recently to our Dominion Parliament the urgent need for better accounting procedures in all Federal Government departments. As was recommended in the Hoover Commission Report made to the United States Government, Mr. Sellar called for public administration on a performance basis. Such an accounting approach is required if we are going to determine the efficiency of individual government bureaus. Chartered accountants can perform no greater service than when their talents and efforts are directed to reduce waste and extravagance where public moneys are concerned.

It has been proposed that double entry accounting procedure could and should be applied by government to foreign trade transactions for the determination of the balance of trade. Such procedure would give more accurate information than the present single entry statistical record obtained from custom export and import returns. Government policy in this area of economic activity could then be based on more complete data. This is an opportunity with an international flavor.

Lest I be accused of thinking only of big things, let me suggest that cost ac-

counting, which is usually associated with big business, be developed by the chartered accountant for adoption in small organizations. Small business, as well as big, needs expert advice.

### Accepting the Challenge

In rising to the challenge of these opportunities, there is, of course, an implied obligation. I think that this obligation means preparation. Throughout this discussion my thoughts pertain primarily to the chartered accountant in public practice, hence my first concern is with his professional standing.

The essence of a profession is service without material gain as the sole incentive. The work cannot be just a job. The accountant's motivating force should be the satisfactory conclusion of the assignment regardless of the reward. You must depend upon personal satisfaction in the main for compensation. Hence those of us in this field must have, first of all, a driving interest in our labours as such, otherwise we are in the wrong vocation. Anyone who is looking for fixed hours, assured take-home pay, security, standardized task assignments, is not going to be happy in this work.

It is not suggested here that chartered accountants take a vow of poverty. Approval of work done with the service spirit will bring monetary reward as well as a satisfying sense of accomplishment.

Dr. Vannevar Bush, president of The Carnegie Institute of Washington, said: "The hallmark of a profession is the assuming of responsibility for the vital affairs of others because of superior specialized knowledge". Sir Harold G. Howitt, F.C.A., said, "I think that really the basic claim to call an occupation a profession is whether the public accept it as a profession. I make so bold as to claim that the public today accept chartered accountancy as a profession and

a very high profession at that". The Carr Saunders Committee on Education for Commerce in England interpreted a profession as follows: "Any body of persons, using a common technique, however meagre in content and however little related to fundamental study, who form as association, one purpose of which is to test competence in the technique by means of examinations."

I have dwelled upon the meaning of profession because our thoughts in this regard must determine our approach to our work. It is not the passing of examinations, the acquisition of a technique, or the acceptance of rules that makes talent acceptable to the public. It is the quality of work.

### The Essentials of a Profession

To assure quality in their work, accountants need, in addition to interest, and willingness to accept responsibility, ability and technical training in accounting, founded on a liberal education with all that term means. There is required, too, a true sense of independence for impartial action. Such independence must be supported by integrity.

While I have largely dealt with the professional accountant, I suggest that the chartered accountant in the management field can very well carry the ideals of service stressed here into his work, where it is very much needed.

Someone has said, "ideas have legs". It is only by advancing thoughts for critical review to interested persons that they can be advanced for general usage. There is no more critical body than a group of students, hence, if the chartered accountant is to advance, he must encourage and develop students' organizations. No man, graduate, or otherwise, has completed his studies while there is a spark of life left in him.

At this point, I cannot help but pass along an excerpt taken from the speech

by Sir Russell Kettle, F.C.A., president of The Institute of Chartered Accountants in England and Wales, to a group of students and reported in *The Accountant* of April 15, 1950. Sir Russell states, "Students' societies afford unique opportunities for acquiring a knowledge both of academic and general subjects, and for discussion and debate. I have looked at the syllabuses of the societies and I believe those who may think that study for examinations does not allow time to take part in the activities of students' societies are missing much of great value in their training and outlook. And apart from the aspect of personal advantage, it should be the duty and privilege of all articled clerks to make some contribution to the profession, of which they aspire to be members, by cooperating with other students and when they qualify, with other members through the district societies, to uphold the reputation and prestige of the Institute. All these activities will help to give you a general background which will assist you not only in your examinations but make your studies and professional life more interesting."

### Using the Opportunities

While "sell" may not be a professional word, selling is what accountants must do. Selling might be defined as the process of persuading people to want what they really need. We know that accounting is essential for efficiency in organized effort, be it for profit or otherwise. Accounting techniques are needed for the control and direction of resources, material and human, to avoid waste in both. Since the chartered accountant is skilled in accounting methods, it is his duty to advance to society the benefits of the techniques that have been developed in this field today.

I do not mean to suggest that we should run full-page advertisements with the occasional dollar day thrown in. But

I do say that by word of mouth and by our actions we can deftly draw the attention of all and sundry to the purpose of accounting and the services the chartered accountant is prepared to render in this field. In speaking of advertising the wares of the chartered accountant, there will surely be mention of the fact that the medical man is not permitted the use of other than his personal professional card and then only under certain stated conditions. I would draw your attention to the evidence that the medical profession is peculiar in that its services, in addition to being essential for a satisfactory life, are greatly influenced by human emotion. It is also true that the advantages of their labours are disseminated by such agencies as government departments of health, life assurance companies, and organizations interested in such afflictions as arthritis, cancer, poliomyelitis, and rheumatism. The chartered accountants should encourage organizations of bankers, credit dealers, insurance companies, investment dealers, labor unions, management, municipal officers, shareholders, and trust companies to suggest spontaneously that their services be utilized. Such organizations have a very real interest in the facts of finance as well as the independent expression of opinion of the chartered accountant. You know we are all prepared in our glassy sophistication to ridicule ritual, but a little colour is a satisfying thing. Who hasn't thrilled at the sight of his flag flying? And, it is true that everybody loves a parade. I maintain that chartered accountants have not enough ritual and flag-flying in their profession.

### Needed: A Little Fan-Fare

The medical doctor, a member of a most respected and learned profession, based as ours is, on art and science, has the Hippocratic oath as well as the familiar symbol of Aesculapius with the winged rod of Mercury encircled by one serpent. It is interesting to note that if you put another serpent on the rod and let him look at the other serpent you get the symbol of Caduceus which represents commerce. As I write, I cannot help but think that by adding to Mercury's rod another serpent with big ears and horn-rimmed glasses and placing it in a watching position as to the other two serpents, we have a symbol at least for the audit function. If you see a person with an iron ring on his little finger you immediately recognize him as a member of the engineering fraternity. How many can recall the details in the symbol of the D.A.C.A. used on the cover page of *The Canadian Chartered Accountant*?

Can we not have, on admission to the Institute, a bit of impressive fan-fare? Then too, can we not have a symbol that will be generally recognized, all within the keeping of professional dignity? To take advantage of the opportunities available to us we must take positive action with an outward expression of enthusiasm for what we have to offer for a better world.

Let it not be said about us:

"These, in the day when Heaven was falling,

The hour when Earth's foundations fled  
Followed their mercenary calling  
And took their wages and are dead."

# Stock-in-trade And the Auditor

By Garfield G. Goult, F.C.A.

This is the second instalment of Mr. Goult's treatise. The first appeared in the August issue; the third and final instalment will appear in the October issue

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## III. THE AUDITOR'S RESPONSIBILITY

### The View in 1896

40. Any paper on the auditor's responsibility for stock-in-trade must include reference to the well-known case of *In Re Kingston Cotton Mill Co.* [1896] 2 Ch. 279 in which stock-in-trade was described in the balance sheets in question "as per manager's certificate". In the Court of Appeal, Lord Justice Lindley said:

The auditors did not profess to guarantee the correctness of this item. They assumed no responsibility for it. They took the item from the manager, and the entry in the balance sheet showed that they did so. I confess I cannot see that their omission to check his returns was a breach of their duty to the company. It is no part of an auditor's duty to take stock. No one contends that it is. He must rely upon other people for details of the stock-in-trade in hand. . . .

41. The matter was taken a little further fifteen years later in *Henry Squire (Cash Chemists) Ltd. v. Ball, Baker & Co.* ((1911) Accountant L.R.) when, after quoting from the *Kingston Cotton Mill* case, the Lord Chief Justice said:

I call attention to these passages. I understand them to lay down this rule that the auditor is not bound to take stock; that the highest which can be put against

an auditor or accountant is the one case or the other is that he is bound to make a reasonable and proper investigation of the accounts and of the stock sheets as far as he can, and if a reasonable and prudent man would have come to the conclusion that there was something wrong, that then it is his duty to call the attention of his employers to it, and in that consideration he is entitled to take into account the fact that the documents are vouched for by trusted servants of his employers . . . I do not quite come to the conclusion — I say nothing with regard to any other case — but I do not quite come to the conclusion that in this particular case the auditors were content to take only the certificate of the managers. They are entitled to rely on the certificate of the managers unquestionably for the reason already given; but I find that the auditors and accountants did in both these cases do more than that. It was their duty to a certain extent to examine the accuracy of the certificates.

The case of *Mead v. Ball, Baker & Co.* was taken to the Court of Appeal ((1911) Accountant L.R.), where the Master of the Rolls said:

Although it is quite clear that it is not the duty of an auditor to take stock, one cannot say that it may not be his duty to call attention to suspicious items appearing in stock sheets which are put before him.



42. It is suggested that the guidance to be drawn from these and other cases is extremely limited, for reasons explained in the succeeding paragraphs dealing with the general principles of an auditor's responsibilities.

#### GENERAL PRINCIPLES

43. No statutory duties relating specifically to stock-in-trade are placed on the auditor of a company. The auditor undertakes a professional service the details of which are left to his own judgment within the broad framework implied by the terms of the report required from him. How he shall discharge his duty is left to the auditor to decide on his experience, judgment and training; but he must be prepared to justify his procedure in a court of law if he is charged with having failed in his duty. In considering stock-in-trade, therefore, it is necessary to examine the general nature of the responsibilities undertaken by an auditor; and for this purpose guidance may be sought in the remarks made by judges of the High Court and the Court of Appeal.

44. In the *Kingston Cotton Mill case* (C.A.) *supra*, Lord Justice Lopes said:

*It is the duty of an auditor to bring to bear on the work he has to perform that skill, care, and caution which a reasonably competent, careful and cautious auditor would use. What is reasonable skill, care, and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog, but not a blood-hound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and to rely upon their representations provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom, but in the absence of anything of that kind he is only bound to be reasonably cautious*

*and careful. . . . The duties of auditors must not be rendered too onerous. Their work is responsible and laborious, and the remuneration moderate. . . . Auditors must not be made liable for not tracking out ingenious and carefully-laid schemes of fraud, when there is nothing to arouse their suspicion and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable.*

In the previous year Lord Justice Lindley had made the following remarks in *In Re London & General Bank* (C.A.) [1896] 2 Ch. 279:

*What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion, very little enquiry will be reasonable and quite sufficient, and in practice, I believe, business men select a few cases haphazard, see that they are right, and assume that others like them are correct also. When suspicion is aroused more care is obviously necessary, but still an auditor is not bound to exercise more than reasonable care and skill even in a case of suspicion; and he is perfectly justified in acting on the opinion of an expert where special knowledge is required. . . .*

45. It is evident from those observations that the emphasis is on the *care, caution and skill which can reasonably be expected of an auditor*. If such is the criterion by which judgment would be passed to-day, then it is important to consider the development of auditing during more than fifty years since the cases referred to above. What may have been reasonable in 1896 may not be considered enough in 1949, and from cases heard in recent years it may safely be assumed that the Court would not hesitate to call expert witnesses from the profession. The conduct of one particular auditor would to no small extent be judged by the general standard prevailing in the profession.

46. The Institute's Royal Charter was



granted in 1880, at which time the importance of auditing compared with insolvency and trust work may be judged from the order of precedence in the petition:

The profession of public accountants in England and Wales is a numerous one and their functions are of great and increasing importance in respect of their employment in the capacities of liquidators acting in the winding-up of companies and of receivers under decrees and of trustees in bankruptcies or arrangements with creditors and in various positions of trust under courts of justice as also in the auditing of the accounts of public companies and of partnerships and otherwise.

47. It would be a reflection on the profession to suggest that auditing technique has not undergone great improvements in nearly 70 years of subsequent development, and it seems clear that what is reasonable care, caution and skill cannot be measured by what may have been the practice when the profession was much younger. The guidance offered by the two cases of 1895 and 1896 would seem to lie in the emphasis on reasonable care, caution and skill and not in the precise facts on which the cases rested. This view is particularly relevant to the subject of this paper, since the *Kingston Cotton Mill* case related to stock-in-trade and it may be assumed, from the stress laid on that case in text books, that auditing practice has probably been based to a considerable extent on that decision. Later cases also lend support to this view. In *Armitage v. Brewer & Knott* (Accountant L.R. (1933)), the judge said:

It is the duty of auditors to be suspicious, that is what they are there for, a view which goes considerably further than those expressed by Lords Justices Lindley and Lopes many years previously.

48. A matter closely connected with stock-in-trade is the omission of invoices for items brought into stock. In the

Irish Court of Appeal as long ago as 1900 Lord Justice Holmes (in *Irish Woollen Co. v. Tyson et al.* (1900 Accountant L.R. 13)) said:

... I am of opinion that if due care and skill had been exercised the carrying over and the suppression of invoices would have been discovered, and the auditor is liable for any damage the company has sustained from the under-statement of liabilities in the balance sheet due to this cause since January 4, 1892. I consider that not only are Mr. Kevans and his assistants not free from blame for this, but also for the mechanical way the audit was carried out.

The last few words have been emphasised as an early indication of judicial opinion that mere mechanical checking is not a reasonable way of discharging an auditor's duty.

49. More recently, in a case involving both omission of invoices and over-statement of work in progress, Mr. Justice Bennett (*In re Westminster Road Construction and Engineering Co.* (1932 Accountant L.R.)) said:

If the auditor found that a company in the course of its business was incurring liabilities of a particular kind, and that the creditors sent in their invoices after an interval and that liabilities of the kind in question must have been incurred during the accountancy period under audit, and that when he was making his audit a sufficient time had not elapsed for the invoices relating to such liabilities to have been received and recorded in the company's books, it became his duty to make specific enquiries as to the existence of such liabilities and also, before he signed a certificate as to the accuracy of the balance sheet, to go through the invoice files of the company in order to see that no invoices relating to liabilities had been omitted. *The evidence has established to my satisfaction that no experienced auditor would have failed to ascertain the existence of the liabilities omitted from this balance sheet.*

Again emphasis has been laid on what seems to be the main guidance offered by this case, namely that the judge based his decision on evidence of the professional skill which could be expected of an auditor.

50. In recent years the case which aroused the most widespread anxiety, not only in the profession but throughout the business world and the investing public, was that of the *Royal Mail Steam Packet Co.* (1931), in which the principal issue was enormous amounts drawn from secret reserves during years of adversity. So far as the balance sheet and the auditors were concerned, the criminal prosecution was unsuccessful, but this case was largely responsible for the more enlightened practice which developed in company accounting and culminated in the *Companies Act, 1948*. Such development was foreshadowed in a leading article in *The Accountant*, August 8, 1931, following the decision in this case:

... the prosecution, though unsuccessful, has very materially altered the map of the accountancy world. Things can never again be as they were. If we judge the situation aright auditors will not be content to run the great risks the existence of which has been disclosed by the very occurrence of this case. The fact that the accusation was possible is not disposed of by the want of success of the prosecution, and no auditor can happily contemplate the possibility that in future, an experiment may be tried in similar, though perhaps different, circumstances, with himself as the victim. . . .

The assertions made in Court by counsel and the comments made by the learned judge in his summing-up make it clear that public opinion has moved. The public now looks to the auditors for a further measure of protection. Shareholders now demand, if not an exact statement of the results of current trading, yet an assurance that the results disclosed by the accounts of the year are not widely different from those accruing from the ordinary trading

processes of the year. If that be a true reading of the situation, new possibilities are, of course, opened up, and we do not think the profession will close its eyes to those possibilities; nor do we think that the argument that the *Royal Mail* case was exceptional in that the existence of current losses was not clearly brought out, will be allowed to deflect consideration from the wider and more general demand by the public for candour in statements of account.

51. Such was the importance attached to this case and the uneasiness engendered by the judge's summing-up that the Council of the Institute obtained the joint opinion of counsel as to whether or not any guidance could be issued to members. The opinion given was as follows (*The Accountant*, December 19, 1931):

52. We have considered very carefully whether the Council of the Institute could properly and usefully issue any form of general pronouncement for the guidance of their members on the questions and matters discussed in the recent case arising out of the affairs of the *Royal Mail Steam Packet Company*.

53. It appears to us, for more reasons than one, that no such pronouncement is really feasible.

54. In the first place, the Council have very responsible functions of a judicial character to perform; and it is of the utmost importance that their hands should be in no way tied by their being committed to statements (which must of necessity be of a wide and general nature) on matters within the purview of their jurisdiction, which might be quoted before them as being applicable to circumstances to which they were not intended to relate.

55. Secondly, it is of the utmost importance that they should say nothing on questions admitting of diverse views that might hamper their members in any possible future proceedings. We can imagine cases arising in which a member resisting a claim might be embarrassed by having a pronouncement of his own Institute quoted against him, when without it a departure

from the general principle laid down could more easily be justified in the special circumstances of his case.

56. The third and perhaps the most formidable difficulty arises from a consideration of the circumstances in which the propositions enunciated by the learned Judge in the case in question came to be propounded. The case in question was a criminal and not a civil case; it related to a chartered company and not a limited company of the ordinary kind, and it rested upon a complicated set of facts and figures which were peculiar to the case, and which formed the foundation of the charge and the text of the summing-up. It is a familiar rule of construction that a judgment should be construed with special reference to the facts of the case in which it is delivered, and that it may be dangerous to take general expressions out of their context and treat them as laying down principles applicable to all possible circumstances. More especially would it be dangerous to do this in the case of a summing-up in a criminal case. The object which the judge has in view in such a case is to furnish the jury with a legal foundation for the particular set of facts on which they are called upon to exercise their judgment. He must always have primarily in mind the details of the particular case, and the fact that the jury are not legal experts.

57. It may well be, therefore, that the Judge in such a case would express himself in different language from that which he would use if he were delivering judgment in a civil action. He may lay down general propositions which are in no way misleading as applied to the facts before the jury, although they may be susceptible of qualification in various directions if sought to be applied to all cases.

58. For these reasons it seems to us that to put together selected extracts from the Judge's summing-up in the case in question, isolated from their context and from the facts of the case, might result in attributing to the Judge an intention to lay down wider propositions of law than were necessary for his purpose or than he really

had in mind. Extracts of this kind must necessarily form the foundation of any pronouncement by the Council, since it is the summing-up in question which has, naturally enough, given rise to requests by members for guidance on the questions with which it dealt.

59. The difficulty then really lies in founding upon any such extracts as we have indicated any principles either of general or of particular application which would both afford a clear guide to a practitioner and be certainly consonant with the law and with the Judge's views. By way of illustration, we may perhaps refer shortly to the question of what are often termed "secret" or "undisclosed" or "inner" reserves. When these expressions are examined, it becomes apparent that they are not expressions which have a clear and well defined meaning and that they, or one or more of them, may be applied to a number of different types of reserve. Probably even experienced accountants would not all agree as to their exact scope and meaning. It follows, therefore, that a general proposition which might be applicable to one type of "secret" reserve might not be applicable to another, or that a given proposition might be applicable to a flagrant or extreme case, though not to one where no "misleading" was involved.

60. We have been asked whether the duties and responsibilities of an auditor extend to the profit and loss account, though it is not specifically reported upon to the members of a company. In our opinion, having regard to the fact that the balance sheet contains as one of its items the balance brought in from the profit and loss account, they cannot dissociate themselves from all responsibility for the correctness of that account and there may be cases in which it would be incumbent upon them to draw the attention of the shareholders to any feature of that account which, in their view, involved anything of an improper or misleading character.

WILFRED GREENE  
CECIL W. TURNER

*Lincoln's Inn,  
November 27, 1931*

61. That opinion did not enable any statement to be issued by the Council, nor has the Council since taken steps to lay down any auditing rules. But the recommendations on accounting principles have achieved the same end in a manner that would never have been possible by the issue of statements on auditing procedure. What the opinion does is to show clearly the limited application of decided cases and it lends substantial support to the view that the most that previous cases lay down by way of general principle is that the auditor will be judged on his care, caution and skill in the circumstances of each case. Of far greater importance to auditors are the new statutory requirements created by the *Companies Act, 1948*, which will now be considered.

#### PROPER BOOKS OF ACCOUNT

62. Under para 2 of the 9th Schedule to the *Companies Act, 1948*, the auditors are required to state in their report:

Whether, in their opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them.

This is an entirely new duty. There may have been many companies where in the past the auditor has required information and explanations which have enabled him to give a clean certificate even though proper books of account have not been kept. Such a course is not now possible and it is, therefore, important to consider what are "proper books of account".

63. The original requirements of s. 122(1) of the 1929 Act have been amplified and now appear in s. 147 of the 1948 Act, subsection (2) being the new provision:

(1) Every company shall cause to be kept proper books of account with respect to:

- (a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place;
- (b) all sales and purchases of goods by the company;
- (c) the assets and liabilities of the company.

(2) For the purposes of the foregoing subsection, proper books of account shall not be deemed to be kept with respect to the matters aforesaid if there are not kept such books as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.

Records of stock-in-trade are too often not all that could be desired. Stock-in-trade is one of "the assets . . . of the company" and movements of stock will form part of "its transactions". But it is difficult to see how these new requirements can affect the auditor's procedure as distinct from his report. Poor or deficient records have frequently required the auditor to exercise a high degree of skill, which will still be required even though he has the additional duty of reporting on the records kept. The main result of the new provisions is likely to be an improvement in records, to the advantage of both the company and the auditor. It should also be noted that subsection (2) of sec. 331 of the *Companies Act, 1948*, which relates to winding-up re-enacts without alteration the provisions of subsection (2) of sec. 274 of the 1929 Act:

For the purposes of this section, proper books of account shall be deemed not to have been kept in the case of any company if there have not been kept such books or accounts as are necessary to exhibit or explain the transactions and financial position of the trade or business of the company, including books containing entries from day to day in sufficient detail of all cash received and paid, and, where the trade or business has involved dealings in goods, statements of the annual stock-takings and (except in the case of goods

sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.

There is no specific requirement in this section that stock accounts must be kept but it seems to call for an accounting procedure which enables goods bought and sold to be identified.

64. In connection with books of account, the provisions of sec. 436 are also new and important. They permit the use of records other than bound books — records which will frequently be employed for stock-in-trade:

(1) Any register, index, minute book or book of account required by this Act to be kept by a company may be kept either by making entries in bound books or by recording the matters in question in any other manner.

(2) Where any such register, index, minute book or book of account is not kept by making entries in a bound book, but some other means, adequate precautions shall be taken for guarding against falsification and facilitating its discovery, and where default is made in complying with this subsection, the company and every officer of the company who is in default shall be liable to a fine not exceeding fifty pounds and further shall be liable to a default fine.

The auditor will have to be satisfied that "adequate precautions" are taken for "safeguarding against falsification and facilitating its discovery". Here again, accepted standards of auditing practice hitherto have made that necessary, but the absence of adequate precautions will presumably now call for comment in the auditor's report.

65. The auditor now has a specific duty under paragraph 3(1) of the 9th Schedule to report:

Whether the company's balance sheet and (unless it is framed as a consolidated profit and loss account) profit and loss

account dealt with by the report are in agreement with the books of account and returns.

Under the 1929 Act the auditor's report included the words "as shown by the books of the company" and the context in which they were used was, in effect, a qualification:

The words "as shown by the books of the company" seem to me to be introduced to relieve the auditors from any responsibility as to affairs of the company kept out of the books and concealed from them, but not to confine it to a mere statement of the correspondence of the balance sheet with the entries in the books. (Lord Justice Rigby in *In Re London & General Bank* (C.A.), *supra* (1895) Accountant L.R.)

The new requirement appears to do precisely what the learned Judge considered the old words did not do. So far as stock-in-trade is concerned no change in responsibility seems to arise, other than what has already been said in paragraphs 63 and 64 above.

### "True and Fair View"

66. Section 149 and the 8th Schedule to the *Companies Act, 1948*, lay down the principles on which a company's profit and loss account and balance sheet are to be drawn up. Following these principles, the auditors are required, under paragraph 3(2) of the 9th Schedule, to report:

Whether, in their opinion, and to the best of their information, and according to the explanations given them, the said accounts give the information required by this Act in the manner so required and give a true and fair view:

- (a) in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and
- (b) in the case of the profit and loss account, of the profit or loss for its financial year.

Thus, the auditor not only has a new statutory duty to report on the profit and loss account; he must also report on the *results of the year*. The question therefore arises whether in relation to stock-in-trade this places any new responsibility on the auditor.

67. So far as the balance sheet is concerned it is difficult to see any increased responsibility in reporting a "true and fair view" as distinct from a "true and correct view" of the stock-in-trade; indeed the new requirement is a relaxation (see, however, para. 69). On the other hand the auditor has hitherto had no statutory responsibility to see that the results of the year have not been distorted by the use of inconsistent bases of valuation. His statutory responsibility is therefore increased by the new legislation.

68. Such increased responsibility has largely been anticipated. In recommendation No. X (already quoted in Section II) the Council recommended that "cost should be calculated on such a basis as will show a fair view of the trend of results" and "whatever basis is adopted for ascertaining cost or calculating market value it should be such as will not distort the view of the real trend of trading results and should be applied consistently regardless of the amount of profits available or losses sustained". The new statutory duty has the effect of enforcing the existing recommendation.

69. One other matter, which may directly affect the auditor in regard to stock-in-trade, arises under para. 27 (2) of the 8th Schedule to the *Companies Act, 1948*:

Where any amount written off or retained by way of providing for . . . diminution in value of assets . . . is in excess of that which, in the opinion of the directors, is reasonably necessary for the purpose, the excess shall be treated for the purposes of this schedule as a reserve and not as a provision.

Apart, therefore, from the general requirement to show a true and fair view, there is a specific prohibition against an undisclosed excessive reduction in the valuation of stock-in-trade. But here again, the legal requirements do no more than enforce the sense of recommendation X: "Any reduction in stock values which exceeds the provisions embodied in the above recommendations is a reserve and should be shown as such in the account" (paragraph 35).

### Conclusions on Responsibility

Having regard to the foregoing considerations it is suggested that the following conclusions are appropriate in regard to stock-in-trade:

70. (a) The auditor's responsibilities are not specifically defined.

71. (b) An auditor may run considerable risk if he relies on reports of cases decided in the past and particularly that of the *Kingston Cotton Mill, supra*. The main import of such cases is to emphasise the exercise of care, caution and skill which can reasonably be expected of an experienced auditor.

72. (c) The *Companies Act, 1948*, places on the auditor responsibilities, which affect him in relation to stock-in-trade, in connection with the state of the books, precautions against falsification of loose-leaf records, the presentation of a true and fair view of the state of affairs and the results of the year, and excessive amounts for diminution in value. These responsibilities require the auditor to be satisfied that the accounts are in accordance with what had already been accepted as best accounting practice; but whereas in the past the auditor has had no power to insist on the adoption of the best practice, he now has a duty to report where the requirements of the Act have not been observed.

(To be concluded)



## Recent Books

**Simplified Municipal Accounting**, published in 1950 by the Municipal Finance Officers Association of the United States and Canada; pp. 162

This manual was compiled by the Association primarily to assist smaller municipalities in setting up accounting systems adequate to meet the growing demand for financial and accounting information. While the contributors admit frankly that they have borrowed many of the ideas and methods found in the publications of eminent authorities on municipal finance and accounting, they have added many new and improved accounting practices of their own.

Although the book is prepared mainly to meet conditions and legal requirements in the United States, the forms used and the methods outlined can, with some modification, be adapted for Canadian use. It should be studied by Canadian readers in conjunction with the "Manual of Instructions" for municipal accountants, published in 1942 by the Dominion Bureau of Statistics, which prescribes the form in which municipal balance sheets and financial statements must be published.

The increasing amount and variety of accounting information and statistics required to be furnished by municipalities to the Dominion and Provincial Governments, as for instance that to be used for determining subsidies, have added to the duties and responsibilities of the municipal accountant. Such being the case, a revision of the accounting system often becomes necessary and this booklet of the Associa-

tion should prove extremely helpful for this purpose. By a copious use of forms and illustrations, it sets out in detail and in ways readily understood, the most up-to-date ideas as to the books and records to be kept, the segregation of accounts by funds, a useful and practical classification of revenue and expenditure accounts, and the statements most likely to be required. Of special interest is an outline of the method used in the preparation of the budget and of budgetary control of expenditures.

Considering the wealth of information it contains, this book should prove invaluable for use not only by municipal officials, but also by public accountants.

GEO. H. GLENNIE, C.A.

**Practical Auditing** (Spicer and Pegler, 9th ed.), by W. W. Bigg; published by H. F. L. (Pub.) Ltd., London; pp. 617 and index, price \$5.00

This well-known English text, now in its ninth edition, continues to be a valuable reference work for both student and practising accountant. Each should find value in comparing current Canadian practice with accepted procedures in other, although not unfamiliar, circumstances. Perhaps the reader will be grateful for refreshing terminology. The use of "casting", "stamp taxes", "carriage accounts", "bought ledgers", and "crossed checks" may lead to interesting reconsideration

CHARLOTTETOWN WELCOMES D.A.C.A. CONVENTION AND VISIT OF R.C.N. FRIGATES



DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS.

CREW MEMBERS OF VISITING NAVY SHIPS.....

*The Charlottetown Guardian*

of familiar things by the practitioner and a broader understanding for the student.

S. G. HENNESSEY, C.A.

**Cost Control in the Boot and Shoe Industry**, by Russell J. Clark; published by Gee & Co. (Pub.) Ltd., London; pp. 77; price 12/4

The publisher's introduction to this book states that it outlines "a practical application of the modern principles of cost control, which have proved so successful in many industries, to meet the special problems of the boot and shoe industry". The author has set out clearly and concisely the steps to be

taken in the installation and operation of a standard cost system. While the book has been written with a view to meeting the specific problems of the boot and shoe industry, with minor modifications the procedures outlined could be adapted to any type of industry to which standard cost methods are applicable. It can therefore have much wider use than in the specific field considered by the author. The book is well written and its usefulness is increased by a substantial number of examples and sample forms. Because of its elementary approach and clear style this book should serve a useful purpose to the student as a practical introduction to standard costs.

K. W. LEMON, C.A.



# A Chartered Accountant Looks at Mutual Funds

By W. Howard Wert, C.A.

## The growth, operation and advantages of a new investment medium

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FOR a long time the accounting profession dealt almost exclusively with the recording of the *history* of business and, therefore, I may be permitted to dwell briefly on the history of mutual funds. They are new-comers in the family of financial institutions. While their roots extend back to the investment trusts of Great Britain and Europe of the 1880's, it was only in the early 1920's that mutual funds, then known as "open-end investment companies", were originated in Boston; and it was not until the early thirties that this great advance in the management of public savings was imported into Canada.

It is, of course, natural that the development of mutual funds in the United States has been greater than in Canada as regards the number of funds, their size and types. It is perhaps due to this earlier and greater development that legislation concerning mutual funds is more advanced across the border.

When the Dominion *Companies Act* was last revised in 1934, only three mutual funds were then in existence in Canada and, as their combined resources were comparatively small, it is not surprising that Parliament did not pass legis-

lation that would permit a capital structure more uniform with the original mutual funds.

### Corporate Structure

To comply with the requirements of the *Companies Act*, Canadian mutual funds are incorporated with two classes of stock, one of which must be non-redeemable and is authorized solely for the purpose of permitting the shares offered to the public to be redeemable. The American funds normally have one class of shares described simply as redeemable; with Canadian funds it is necessary to add the qualification "to the extent paid-in surplus is available". This, again, is to comply with the requirement of the *Companies Act* that redemptions be made only out of surplus unless supplementary letters patent be obtained. It is not a restriction imposed by the Canadian funds to place difficulties in the way of redemptions.

Paid-in surplus is established in the accounts of Canadian funds by allocating to a paid-in surplus account the proceeds of the sale of its shares in excess of their par or stated value. For example, \$4 is received for the sale of a share, \$1 is

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An address to the Third Canadian Forum on Mutual Funds, Montreal, May, 1950

usually credited to capital account and the remaining \$3 to paid-in surplus. With the issue of many shares, a substantial paid-in surplus is created and is made available for the redemption of shares in the ordinary course of business.

When shares are redeemed, the entire redemption price (including the amount originally credited to capital account) is a charge against paid-in surplus with the result that the number of shares then outstanding no longer bears any direct relationship to the dollars remaining in capital account. Although this may appear illogical, I am advised that it is the proper treatment of redemptions, and what appears to be the logical presentation of accounts — whereby the amount originally credited to capital account is charged against that account — is not in keeping with the charters of Canadian mutual funds, nor with the proper procedures under the *Companies Act*.

I look forward to a change in the Act which will permit the presentation of these accounts in a simpler form; and I would suggest that the financial statements required by the Act for mutual funds be comparative in form. Results of operations should be related to the number of shares outstanding and investments should be valued on the balance sheet at market values (showing cost as a footnote) so that the capital and surplus accounts reflect the market value of the shareholders' equity.

#### Income Tax

While certain legislation, under which Canadian funds labour, may be outmoded, there is no such complaint with regard to their operation under the *Income Tax Act*, although the effect of some sections of the Act is still obscure. As most of us are aware, this Act is constantly under revision. Any investment company which meets the following requirements is presently exempt from taxation under the Act:

- (a) At least 80% of its assets throughout the year was in marketable securities or cash;
- (b) Not less than 95% of its income was from these investments;
- (c) Not more than 10% of its assets was invested in any one corporation;
- (d) Its shares were held throughout the year by at least 50 or more persons, of whom none held more than 25%;
- (e) At least 85% of its net income for the year was distributed before the end of the year as dividends to its shareholders.

The underlying concept is that a duly qualified investment company is essentially a co-operative effort on the part of a large number of investors and that they should not be penalized because they have joined together for their mutual benefit.

Should, however, an investment company desire to become taxable in the same manner as any other commercial corporation, it may so elect under the Act. This election should be made only after a careful study of what appears to be the best interests of the shareholders. The amount of taxes to be paid by the fund must be weighed against the estimated tax credits to be made available to the shareholders.

Regardless of whether the election is made or not, the directors should always aim to give the greatest benefit to the greatest number of shareholders. The expenses of operating the fund should be charged against income, and dividends paid to shareholders should not exceed the net income so calculated. Nothing should be done that has the effect of causing shareholders to pay income taxes in excess of what they would have paid had they not entrusted the management of their capital to the fund.

#### Costs

It is second nature for accountants to think of costs — those of acquisition and

those of upkeep. Distribution and the giving of service costs money in the financial business as well as in any other business. In the underwriting of higher grade securities the margin of profit has become small, perhaps dangerously so, and if the underwriter wishes to service his clients properly with respect to an issue over its entire term, it is often done at his own expense. A mutual fund is a service organization, its responsibilities to the investor do not cease when its shares are sold to him—they begin at that point; and when the overall benefits to the investor are taken into account, the costs assume their relative importance. The price for *one* error of judgment is seldom as low as 9%.

The initial cost, while seemingly higher than the average of that of issues of similar quality, covers both the costs of purchase and of eventual redemption and many other factors; and if we compare total costs it must be remembered that the buyer of the individual securities pays close to the asked and sells close to the bid—a difference that is often substantial; and if he is investing a comparatively large sum of money there is the danger of running up the market on himself, or conversely, if he is selling, there is the danger of depressing the market by his own sales. There is no discount from the book value of the underlying assets to take into account, either when buying or selling, because it is the standard practice of mutual funds to determine the value of their shares daily to the nearest cent. I would be disappointed if any fund with which I was associated did not follow such a policy, as convenience of operation should not interfere with the precise determination of the value of the shares.

The other cost to be considered by the investor is that of upkeep, or the costs of operating the fund. These are chiefly payments to the research organizations,

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the custodian of securities, the dividend disbursing agents, the transfer agents, the directors, the cost of clerical services, office expenses and, in a modest amount, the fees of the auditor. Here, again, costs must be weighed in view of what the investor receives for his money. It might be said that the investor could avoid this charge if he did the work for himself, but unless the investor has very large sums at his disposal or is unusually well-versed in business and finance, it is obvious that his true cost will be greatly in excess of that of the mutual fund and his analyses of investments much less comprehensive than those prepared by the fund.

#### Law of Averages

It should not be supposed that mutual funds cannot make mistakes. Investing is a matter of judgment; it is not a mathematical formula, but the law of averages does come to the assistance of mutual funds. The following is based on actual facts:

Let us suppose an investor purchased a certain security in June 1947 which was well regarded and which then yielded 5.9% and that he has continued to hold this security. Today, his capital would have depreciated by 80% and his income for the last two and a half years would have been *nil*. Let us suppose that instead he purchased on that same date shares in either of two Canadian mutual funds, which actually purchased and have

continued to hold that same security. Today, his capital would show a slight appreciation (after absorbing the initial charge) and his income, though slightly lower initially, would not only have remained intact throughout the period but would have been increased.

It is thus seen that mutual funds offer a shelter from the full brunt of the storm. How often in closing out the estates of successful businessmen, members of my profession have seen the wreckage of past ventures outnumber those that have stood the test of time!

Mutual funds in Canada have been designed for the investor—not for the trader or speculator. They should be sold primarily as a longer-term investment. They appear to be ideally suited for savings programmes—whether the programme is systematic or one which calls for investment only as funds become available. They are designed for those who seek in varying degrees:

- Income;
- Preservation of capital and income;
- Long term capital appreciation.

### Types

Leaving out of consideration certain specialized types of funds not yet organized in Canada, the main types of funds designed to meet these objectives are:

- Diversified common stock funds,*
- Balanced funds, and*
- Leverage funds.*

The yardstick for judging the performance of the various types of funds is not simply to compare their performance with the variations in any single index of stock market prices, but rather to compare their long-term performance with what the management undertook to do for the investor. Too many people are prone to judge performance by comparing the changes in the price of mutual funds with a selected market average which more often than not reflects the

movements of a particular group of stocks, instead of the more numerous categories which comprise a typical mutual fund portfolio.

An investor expects greater variations in the price of a common stock fund than in a balanced fund. He also expects more income and greater long-term capital appreciation.

The balanced fund appeals to those seeking a more conservative course and who look to management to anticipate, within limits, major shifts in security price levels.

The leverage funds appeal to those who are willing to not only put their money to work, but are willing to hire other money to work for them. The criticism of a mutual fund borrowing money for investment on a limited and prudent basis is unjustified, unless it is admitted that the companies whose securities are held by any type of mutual fund should not borrow money for investment in plant and equipment. I suggest that the public utilities, for example, should not be criticized for so financing, in part, their operations.

### Common Features

However, regardless of type of fund and of its investment policies, certain features are common to all:

#### *Simplicity of Participation*

Shares may be purchased at any time without penalty for late entry and without injury to the interests of those already participating. The fund receives for the issue of new shares the exact value of the old.

#### *Simplicity of Diversification*

Diversification is necessary for intelligent investing, but is normally impossible of economic fulfilment for the ordinary person. One security represents a carefully selected and constantly supervised

participation in approximately 75 enterprises. The shares of mutual funds are one of the simplest forms of security to hold for succession duty purposes.

#### *Simplicity of Operation*

The investor receives income four times each year from one source. This brings with it less complications in book-keeping and the preparation of tax returns. Dividend cheques are accompanied by reports setting a standard of disclosure almost unique among public companies.

#### *Simplicity of Withdrawal*

Withdrawal for any purpose or for any reason, including dissatisfaction with the management, is without penalty through the privilege of redemption of shares. Management, in determining policies and the selection of investments, must constantly bear in mind the fact that the shareholders' equity in the fund is in effect call money.

#### **Desirable Investment Medium**

The shares of mutual funds have become widely known as a desirable medium for the investor of comparatively small means. They should also be attractive to

all those who are consulted concerning or entrusted with the investing of money, in that they permit an intelligent servicing of accounts at a fee more in keeping (than mere brokerage) with services rendered. It is interesting to note the increasingly wide acceptance of mutual funds among institutional investors and individuals of substantial means. The shares of mutual funds should be attractive even to the most competent of investors as a hedge against their own judgment.

Two thousand years ago property of many kinds was entrusted to the management of others. It is less than 30 years since a system was devised whereby capital could be entrusted by anyone to professional management and withdrawn, on exactly equal terms at any time, by anyone participating in the plan. Although the plan is new, it has survived the deepest and most prolonged depression and the greatest war of modern times.

The responsibility of management is to maintain and enhance the highest principles of trusteeship of public savings. If it is successful, the stabilizing effect of mutual funds on the economy of our country may well be greater than presently can be imagined.

## Forms

By R. P. Egerton, C.A.

### The use of scientifically designed forms is a vital part of systems development

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**E**ACH year man exists he adds to the pool of knowledge, leaving behind him a store from which future generations may draw. Thus the man of today may learn in a few years what his forefathers spent a lifetime discovering. One consequence of this has been that subjects formerly studied as a whole must now be broken down into branches, each branch being more than enough to occupy a lifetime of study by one man. This leads to specializing in a particular branch of a subject and the term "specialist". And so we have mechanical, electrical, civil, and forestry engineers, specialists in the field of medicine and surgery, and groups of lawyers each of whom concentrates on a particular branch of legal procedure.

The operation and conduct of a business is no exception. Two factors which have forced the concentrated study of management problems are the rapid rise in the rate of wages paid and the consequent increase in the tempo of business. For example, when presses were used for copying letters, salaries of \$25 to \$30 a month were common. Now with salaries of \$100 to \$150 a month this process would be

too expensive to be used and cheaper ways of getting copies have had to be devised and adopted.

#### Productivity

The consequence has been that in the field of production greater and greater sums have been spent on equipment and research to keep volume of production in line with the wages paid. And in the field of management it has been found profitable to have minute studies made of all functions so that each individual will produce the maximum of useful work. While in most cases there are members of a company's staff who have sufficient knowledge to make some improvements, they have neither the time nor the training to discover and institute all the improvements which can be made.

#### Systems Analysis

The whole phase of examining into the functions of a business is frequently referred to under the broad term of "systems analysis". This is, however, much too large an operation to be covered efficiently by any one group of advisors. There are the physical processes of production which can quite

properly be studied and advised upon by engineers trained in this work. There are the accounts and documents dealing with accounting and costing processes which can logically be analyzed by accountants. But in addition to these two phases there are a host of forms which set in motion all the business functions of an enterprise. The design and construction of these are arts in themselves and they can be produced only by skilled artisans using precision equipment. It is felt that a useful purpose will be served if an outline is given of some of the problems involved in the design and construction of forms and the type of service which is available for the benefit of the users.

#### Units of Measurement

To give some idea of the sort of thinking which is done in designing a form, one unit of measurement which is used is .0062 minutes or six and two tenths thousandths of a minute. This represents the normal time required to strike one key of a typewriter and is mentioned as an example to show the kind of detailed research which has been carried out. The results of this research are available to those whose business it is to render this sort of service. In this business the old Scottish saying that "Many a mickle makes a muckle" holds doubly true.

#### Some Features of Form Design

From such studies it has been found that attention must be paid to details often considered too minute or unimportant by those not familiar with this phase of business. From such findings, too, it has been established that the cost of making out a form is at least 10 times the cost of the form itself, even with forms of proper design, whereas the cost of making out a poor-

ly designed form can be more than 25 times the cost of the form. A form should therefore be examined to determine:

- (a) whether as much pre-printing has been done as possible. (For example if the terms are always net 30 days, "Terms net 30 days" can be printed instead of printing "Terms" and typing "Net 30 days");
- (b) if the form is arranged so that the typing can be done in a natural flow as in typing a letter;
- (c) if the form is as compact as possible;
- (d) if the form can be arranged so that it will serve more than one purpose. (For example, can copies of the purchase order be used as receiving slips?);
- (e) whether the design of the form is as economical as possible from the point of view of printing expense and the number of copies required.

(See *Exhibits A and B* on pp. 118-119).

Notice the relative importance assigned to (e). Though this item of expense should by no means be ignored, it is obviously unwise to save in the cost of printing if the cost of making out the form will increase as a result, or if the purpose of any copy will be in doubt.

#### Functions of Business

Though the cost of the forms and the cost of making them out are important features, the greatest scope for savings through improvements in efficiency lies in the activities set in motion by the forms. Nearly every action taken in a business of any size results from some writing on a piece of paper. This writing may be in longhand or typed; it may request or order some-



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After some banking experience and during the course of 11 years with Price Waterhouse & Co. in Montreal, Mr. R. P. Egerton, C.A. was admitted to the Quebec Institute in 1928. He was later treasurer of The E. B. Eddy Co. Ltd. for 11 years, has done war work with the Treasury Cost Accounting Division and Canadian Vickers Ltd., served on the Ontario Royal Commission on Forestry and with the Canadian Lumbermen's Association. He was admitted to the Ontario Institute in 1946 and is now a special representative in Montreal of R. L. Crain Limited of Ottawa.

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thing to be done or it may be informative and calling for some action to be taken in the future.

Again as the result of studies made it can be determined whether or not these documents can best be handwritten or made out by some type of business machine. As well as the design of the form, the method to be used and the number of copies required must be considered; the type of business machine to be used and its capabilities, the legibility of the copies produced, and the registration on these copies must all be taken into account. There is not one phase of a business to which there is not some possible application of the experience of those who have earned a good reputation through the quality of their forms and their honest advice even to the exclusion of their own products if they are not suitable.

The experienced producers of forms must also design their forms to suit the machines over which they are to be operated. This makes it necessary to keep abreast of every change in design

of all business machines. The war forced great advances in the design of machines of production, but less attention was paid to business machines. During the next 10 years, however, some startling developments will take place and part of the service offered by reputable producers of forms is in keeping their customers advised of the latest features in all kinds of business machines.

#### Continuous Forms

In order to reduce to a minimum the cost of making out forms, efforts have been directed towards eliminating non-productive motions, such as inserting carbons between forms, joggling together forms in a set, putting the set into a machine, aligning the set for typing, and removing carbons one by one. Forms have, therefore, been printed in continuous strips with perforations between parts and are supplied with carbon paper interleaved between the original and the copies. In this way it is possible to align only the first form of a strip for typing and, on tearing off a completed set, to find the next form in position ready for typing. Methods have also been devised for removing all carbons at one time with one pull from the completed set. The saving in time, where continuous carbon-interleaved forms can be used, and in the case of individual sets of forms, more than pays for the cost of the carbon thrown away after one use.

#### Routine and Service

The makers of continuous forms who have had experience in systems surveys have become acutely conscious of the fact that the form design and the routing of the copies of the completed form may result in producing order out of chaos in the routine of business. Improvements effected have been so marked that more importance



is attached to service rendered than to an order for printing obtained. Service has been carried to the point of making a detailed analysis of paperwork routine before designing tailor-made forms to suit the particular business under study. Furthermore, experts are available who can design devices for particular purposes. Though forms are tailor-made to fit each business, the suppliers have libraries consisting of thousands of samples of forms in successful use to guide them in solving special problems.

### Accounting

No procedure can be set in motion properly without the use of forms of one kind or another. It has been shown that the experienced producers of continuous forms have specialized, not only in their design and production, but also in the routine to which they give rise. Because of the high cost of making out a form compared with the cost of the form itself, the possibility of preparing, in one operation, forms which serve two or more different functions becomes a question of importance. Such forms can be designed best by those with experience and a thorough knowledge of the problems involved in their production. If multiple purpose forms are feasible, the first part may serve a purely accounting function and the others may serve functions related entirely to the physical processes in connection with the production and handling of goods. Thus the studies of form designers have embraced every phase of business activity.

Now it might be inferred that there is some overlapping, some clashing of interests between systems accountants and the manufacturers of continuous forms. But in actual fact there is the common aim of having the business of

the client or customer function as smoothly and efficiently as possible.

However, an examination of the possible situations which might arise in the normal and natural course of business may suggest the best policy to pursue, that is, the policy which is most likely to benefit the client or customer, the systems accountants and the forms experts.

The installation of a system by accountants may be at the request of the client or on the advice of the accountants that a proper audit cannot be carried out unless the client's accounting, costing and bookkeeping routine is put on a sound basis. The accountants may carry out their work with or without consultation with reputable designers and producers of forms.

Forms experts are confident they have a service to offer which may be of benefit to their customers and they are not restricted by their code of ethics from searching for new fields in which their services may be rendered. They may accordingly make improvements to systems based on their experience in paperwork and the design and quality of their products. This may be done with or without consulting the customer's accountants. It might be done subsequent to the installation of a system by the accountants.

Unless each knows the aims and scope of the other, these two groups of advisors, both vitally interested in systems work, will wander independently, each making some change here or there in the routine of the business. Whereas if the two groups work harmoniously and with mutual confidence, the best possible systems installations can be made at one time. There is no doubt as to which of the two policies will be of more benefit to the client and customer.

EXHIBIT ATHE OLD FORM **BEFORE** REDESIGN

**Any Manufacturing  
COMPANY**  
ANY ADDRESS, CANADA

INVOICE DATE T1

SOLD TO T1

DATE OF ORDER T1      SALESMAN T1  
CUSTOMER'S ORDER NO. T1      TERMS T1  
REQUESTION NO. T1      PRICE T1  
CONTRACT NO. T1      DATE SHIPPED T2  
SHIP TO T1      PERIOD ON CREDIT T1  
T1      INVOICE NO. T1

GOODS RETURNED WITHOUT OUR PERMISSION WILL NOT BE ACCEPTED.  
CLAIMS FOR DAMAGES MUST BE MADE TO THE TRANSPORTATION COMPANY.  
SHORTAGES MUST BE REPORTED WITHIN 10 DAYS BY RECEIPT OF SHIPMENT.

FULL CREDIT WILL BE ALLOWED FOR THE RETURN OF ALL EMPTY  
CONTAINERS CHARGED FOR FREIGHTS THAT ARE RETURNED FREIGHT  
AND IN GOOD CONDITION.

FOR CUSTOMER USE ONLY	
REGISTER NO.	VEHICLE NO.
F. R. CHECKED	CALCULATIONS CHECKED
TERMS APPROVED	PRICE APPROVED
MATERIAL RECEIVED    BILL NO.    AMOUNT	
BY	
DATE	SIGNATURE    TITLE
SATISFACTORY AND APPROVED	
CREDITING DISTRIBUTION	
NOTED	FILED APPROVAL

QTY. ORDERED	QTY. SHIPPED	DESCRIPTION	PRICE	AMOUNT	TOTAL
T1	T1	SHIP	T1	T1	T2

○ INVOICE ○

T1 ——— FIRST TYPING OPERATION  
T2 - - - - - SECOND TYPING OPERATION

**FORM FACTS**

- TWO FOLDS REQUIRED TO FIT PRESENT ENVELOPE
- FORM SIZE COULD BE REDUCED
- CUSTOMER BOX UNNECESSARY—HEADING NOT CENTERED ON FORM
- LEFT MARGIN TYPING NOT UTILIZED
- TAB STOPS NOT UTILIZED
- POOR SEQUENCE OF ITEMS FOR EFFICIENT TYPING
- EXCESSIVE LINE SPACING DUE TO VERTICAL ARRANGEMENT OF ITEMS
- TYPING THROUGH PRINTED MATTER
- TOTAL COLUMN UNNECESSARY
- T1 AND T2 TYPING NOT GROUPED
- WASTED SPACE DUE TO CHARACTER SPLITTING BY VERTICAL RULES
- PREPRINTED PRODUCTS COULD BE SHOWN
- WASTE SPACE AT BOTTOM OF FORM

## THE NEW FORM **AFTER** REDESIGN

T<sub>1</sub> ————— FIRST TYPING OPERATION  
T<sub>2</sub> - - - - - SECOND TYPING OPERATION

- ONE FOLD REQUIRED TO FIT NEW WINDOW ENVELOPE
- FORM SIZE REDUCED, WITHOUT REDUCTION IN TYPING SPACE
- CUSTOMER'S BOX AND TOTAL COLUMN ELIMINATED
- ALL TYPING STARTS AT LEFT MARGIN
- ITEMS ARRANGED HORIZONTALLY FOR FASTER TYPING
- 1st AND 2nd TYPING GROUPED FOR REOPERATION
- PRODUCTS PREPRINTED IN BODY OF FORM
- DEAD SPACE ON FORM USED FOR PREPRINTED INFORMATION
- PARTS OF FORM STITCHED WITH CARBONS FOR EFFICIENT REOPERATION

- REDUCTION IN TYPISTS TIME
- ACTUAL \$ SAVINGS IN LABOUR
- INCREASED PRODUCTION THROUGH FORM DESIGN
- PAPER SAVINGS THROUGH REDUCTION IN SIZE

## Letters from Readers

### DEPRECIATION AND "GOOD ACCOUNTING PRINCIPLES"

Kingston, July 16, 1950

Sir: I read with interest the very informative article in your June issue by Mr. A. W. Gilmour under the heading "Diminishing Balance Depreciation Under the Income Tax Act".

I feel, however, that some qualification is necessary in the statement made as to "good accounting principles" on p. 276. Mr. Gilmour states that, "As accountants we claim that a capital profit or loss arises when an asset is sold for an amount greater or less than the depreciated book value, and where this occurs we remove the asset value, the accumulated depreciation from the balance sheet, and transfer the resultant profit or loss to a capital surplus account."

In my opinion, the use of the terms "capital profit" and "capital surplus" is extremely unfortunate in this connection. Many accountants have pointed out the unsatisfactory nature of these terms (for example see p. 387 of the seventh edition of Montgomery's *Auditing*).

Likewise, I disagree emphatically with the statement that a "profit" of any sort arises when an asset is sold for an amount greater than "depreciated book value" but smaller than the original purchase price. For example, assume that a fixed asset is purchased for \$10,000; over the years \$9,000 of estimated depreciation is recorded on the books and the disposal price as scrap is \$2,000. According to the rule quoted above, a "capital profit" of \$1,000 has arisen which we, as accountants, would transfer to a "capital surplus" account.

My view is that, in such a situation, this treatment is extremely questionable. The simple fact is that ownership and use of the fixed asset has cost the business \$8,000 which,

in my opinion, should be the amount of the charge against earnings over the period of the useful life of the asset. The burden of proof rests very heavily on the accountant who contends that the correct charge against earnings is \$9,000 and that the \$1,000 adjustment on disposal is a "capital profit".

I therefore feel that this positive and unqualified statement concerning the accounting principles relevant to such a situation should not be permitted to stand unchallenged.

W. G. LEONARD, C.A.  
*Queen's University*

### TO INCORPORATE OR NOT TO INCORPORATE

Peterborough, Ont., Aug. 14, 1950

Sir: Since the article "To Incorporate or Not to Incorporate" was written (*The Canadian Chartered Accountant*, March 1950, p. 121), there has been introduced into the *Income Tax Act* provision whereby a corporation, provided it fulfils certain requirements under the Act, may set aside a portion of its earnings as "tax-paid undistributed income" by the payment of a special tax of 15% thereon. It is a measure designed to eliminate to some extent the hardship experienced by closely-held corporations whose growth had been financed out of retained profits and which, in the past, were obliged to meet succession duties arising from the death of a principal shareholder by the payment in the one year of a substantial dividend. It is designed also to encourage the payment of dividends out of current earnings, while at the same time making it possible for a company to capitalize profits essential for growth and expansion without imposing on shareholders an almost impossible potential tax burden.

The Act now provides that a corporation having not more than 75 shareholders may

elect to pay a special tax of 15% on its total undistributed income accumulated to the end of its 1949 fiscal year and, having done that, may, to the extent that it pays out earnings in dividends subsequent to 1949, earn the right to "set aside" an equivalent amount upon the payment of the special tax of 15% thereon. The total of its undistributed income accumulated to the end of 1949 less the special tax of 15% paid thereon is then classified as "tax-paid undistributed income". The same classification is given to the earnings after 1949 which have been "set aside", less the 15% paid in respect thereof. This "tax-paid undistributed income", created as above, may be capitalized in accordance with accepted company law procedures and thus placed in the hands of shareholders without further tax.

In the article referred to above, a comparison was made indicating income taxes payable as a sole-proprietorship and those payable by the corporation and shareholder-owner. One of the columns developed therein showed the combined tax payable on the basis of a full distribution of the corporation's profits for the year, representing a salary withdrawal of \$8,000, the balance as a dividend in the same year. In view of this new piece of legislation it is interesting to insert another column indicating the combined tax payable on the basis of a full distribution of the year's earnings, such distribution, however, to represent a salary withdrawal of \$8,000, the balance being divided equally between a dividend payment and the creation of "tax-paid undistributed income".

	Proprietor	Corporation		Shareholder-owner
		Regular	Special	
Profit before salary .....	15,000	15,000		
Salary .....		8,000		8,000
Dividend .....				2,905
Balance of earnings .....			2,905	
				10,905
Exemption .....	2,000			2,000
Taxable income .....	13,000	7,000		8,905
Income tax .....	3,360	1,190*		1,931
Special 15% tax .....			436	
Investment surtax .....				20
				1,951
Dividend credit .....				291
				1,660
Tax-paid undistributed income .....			2,469	

\* 10% on \$7,000 plus Ontario corporation tax of 7% on \$7,000

The comparison may then be shown as follows. Comment has already been made concerning the limitations of such a comparison and it is worth noting that there is no time limit as to when a corporation may take advantage of the new 15% provision. Before a corporation, however, can deal with earnings

after 1949 it must first have paid the 15% tax in respect of its undistributed income accumulated to the end of 1949 and must have paid out dividends subsequent to 1949 to earn the right to capitalize any of its earnings after that date.

J. A. MCCOLL, C.A.

On basis of following profits before salary	Tax payable as a sole proprietorship	Combined tax payable on basis of leaving all but salary of \$8,000 in the business	Combined tax payable on basis of withdrawing \$8,000 salary and balance as a dividend	Combined tax payable on basis of withdrawing \$8,000 salary and balance divided equally between a dividend and capitalized profits <i>In the same year</i>
\$10,000	1,660	1,480	1,746	1,738
15,000	3,360	2,330	3,639	3,286
20,000	5,510	3,640	6,219	5,353
25,000	7,760	5,640	9,389	8,026
30,000	10,160	7,640	12,559	10,761
40,000	15,160	11,640	19,024	16,318

#### MR. GILMOUR CORRECTS AN ERROR

Montreal, July 12, 1950

Sir: It has been drawn to my attention that an error was made by me in the article on "Depreciation" published in the June, 1950 issue of *The Canadian Chartered Accountant*.

On p. 281, an illustration is given of the amount of depreciation which could be claimed in respect of an asset which originally cost \$100 and had been depreciated to \$40 by the end of 1948, by the deduction of \$30 normal and \$30 double depreciation. In

the article, it was stated that normal depreciation in 1949 would be 20% of \$70, whereas it should have been 20% of \$40. The corrected calculation is:

20% of \$40, being original cost of \$100 less depreciation of \$60 .... \$ 8  
10% of \$100, being one-half of the amount which could have been claimed had the provisions of the *Income War Tax Act* remained in force ..... 10

\$18

A. W. GILMOUR, C.A.

# Annual Meetings of the Institutes

## ELECTION OF OFFICERS

### Alberta

The 39th annual meeting of the Institute of Chartered Accountants of Alberta was held on June 23, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* J. L. Kergan

*Vice-Presidents:* A. G. Burton, J. M. Tweddle

*Secretary-Treasurer:* M. C. McCannel

*Members of Council:* A. G. Burton, E. Connelly, J. G. Duncan, A. J. Hamilton, J. L. Kergan, L. J. Munn, M. C. McCannel, J. S. Simpson, J. M. Tweddle

*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
J. S. Simpson, J. L. Kergan, A. G. Burton

### British Columbia

The 45th annual meeting of the Institute of Chartered Accountants of British Columbia was held on June 28, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* W. Grant Ross

*Vice-President:* J. E. McIntosh

*Secretary-Treasurer:* H. Norman Lunn

*Members of Council:* E. A. Campbell, C. V. B. Corbet, G. F. Dunn, E. M. Gunderson, J. G. Halpin, J. L. Helliwell, D. R. Lukin Johnston, J. R. A. Kinninmont, J. E. McIntosh, J. Lorn McLean, A. M. Reid, W. Grant Ross

*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
W. Grant Ross, J. L. Helliwell, J. Lorn McLean

### Manitoba

The 64th annual meeting of the Institute of Chartered Accountants of Manitoba was held on June 28, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* S. B. Laing

*Vice-President:* William Young

*Secretary-Treasurer:* J. A. T. Shelton

*Members of Council for two years:* J. W. Abbott, William Aitken, F. L. Green, Daniel Sprague, W. D. M. Stewart, H. J. Wookey, William Young

*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
S. B. Laing, William Young, J. S. Swinden

### New Brunswick

The annual meeting of the New Brunswick Institute of Chartered Accountants was held on June 29, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* G. W. Hudson

*Vice-President:* E. A. Mowatt

*Secretary-Treasurer:* F. P. Blackmore

*Members of Council:* W. W. Dick, R. S. FitzRandolph, I. E. Laws, J. A. Marven, G. A. Oulton, George Smith

*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
G. W. Hudson, E. A. Mowatt

### Newfoundland

The annual meeting of The Institute of Chartered Accountants of Newfoundland was held on June 23, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* R. Leith

*Vice-President:* R. B. Moyse

*Secretary-Treasurer:* J. Hyslop

*Members of Council:* G. W. D. Allen, H. R. Brooks, C. D. Drysdale, H. J. McDougall, G. C. Rowe

*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
R. Leith and R. B. Moyse

### Nova Scotia

The annual meeting of the Institute of Chartered Accountants of Nova Scotia was held on June 26, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* Harold J. Egan

*Vice-President:* William Wood

*Secretary-Treasurer:* Robin C. Buchanan

*Members of Council:* E. M. Davison, H. R. Doane, R. D. Evans, C. W. Gurnham, G. E. Hayman, S. S. MacIntosh, G. L. Peverill, F. L. Silver, J. G. Vickery

*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
Harold J. Egan, William Wood

### Ontario

The annual meeting of the Institute of Chartered Accountants of Ontario was held on June 28, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* H. E. Crate

*Vice-Presidents:* J. A. Wilson, B. A. Armstrong

*Secretary:* W. L. L. McDonald

*Treasurer:* D. A. Ampleford

*Members of Council:* G. W. Benson, W. M. Brace, M. A. Bradshaw, W. I. Hetherington, W. T. Millard, G. H. Spence, R. S. Watson, W. F. Williams, J. R. M. Wilson

*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
H. E. Crate, J. A. Wilson, B. A. Armstrong

### Prince Edward Island

The annual meeting of the Institute of Chartered Accountants of Prince Edward Island was held on June 16, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* W. A. Morrell

*Vice-President:* T. E. Hickey

*Secretary-Treasurer:* W. G. Thompson



*Members of Council:* J. W. Dixon, T. E. Hickey, P. A. Lawrence, J. R. Leard, R. W. Manning, W. E. Massey, W. A. Morrell, B. M. Sears, W. G. Thompson  
*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
B. M. Sears, T. E. Hickey

### Quebec

The 70th annual meeting of the Institute of Chartered Accountants of Quebec was held on June 28, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* Jean Valiquette

*First Vice-President:* G. P. Keeping

*Second Vice-President:* J. A. de Lalanne

*Honorary Secretary-Treasurer:* Jean-Paul Gauthier

*Immediate Past President:* C. N. Knowles

*Members of Council for two years:* R. R. Bédard, Henri Ferron, C. D. Mellor, S. B. Peckham, Cecil Vineberg

*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
Jean Valiquette, G. P. Keeping, C. N. Knowles

### Saskatchewan

The 42nd annual meeting of the Institute of Chartered Accountants of Saskatchewan was held on June 24, 1950.

The following officers and members of Council were elected for the year 1950-51:

*President:* S. O. McMillan

*Vice-President:* H. S. Moffet

*Secretary-Treasurer:* T. H. Moffet

*Members of Council:* R. L. Bamford, E. C. Gerry, H. A. Hunt, H. S. Moffet, C. H. Smith, F. H. H. Smith, S. O. McMillan, J. H. Thompson, T. R. Wilder

*Representatives on the Council of the Dominion Association of Chartered Accountants:*  
S. O. McMillan, E. C. Gerry, H. S. Moffet

## Professional Notes

### ALBERTA

Mr. Arthur Maw, C.A. announces the opening of an office for the practice of his profession at 405-407 Maclean Block, 109 8th Ave. E., Calgary.

### NEW BRUNSWICK

New Brunswick Students' Society

The annual meeting of the Chartered Accountants Students' Society was held recently at the officers' mess of the New Brunswick Scottish Regiment in Saint John. Officers elected for the coming year are: *president*, J. K. Logan; *vice-president*, J. F. Lenihan; *secretary-treasurer*, F. M. McCullum. Messrs. D. W. Cherry, J. E. Miller, and F. M. G. Taylor are members of the general executive.

### ONTARIO

George A. Touche & Co., Chartered Accountants, announce that Matthews Brothers & Co., Chartered Accountants, 424 Princess St., Kingston, will act as correspondents for George A. Touche & Co. in Kingston and that Mr. O. A. Matthews will act as consultant to both firms.

### QUEBEC

Mr. W. J. T. Adamson, C.A. announces the admission to partnership of Mr. J. Wesley Morrison, C.A. as of June 1, 1950. The partnership will practise the profession under the firm name of W. J. T. Adamson & Co., Chartered Accountants, Birks Bldg., Montreal.

# The Students' Department

J. E. Smyth, C.A., Editor

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## NOTES AND COMMENTS

**T**HE *pros* and *cons* of the granting of pensions to employees by some of the larger U.S. companies last year have now had some time to sort themselves out, and we find certain aspects of this question quite intriguing.

The "reserve (or allowance) for employees' pensions" is, as we have been taught, a kind of liability; but since it provides for estimated payments most of which will not be made in the next business year, it is best excluded from the current liability section of the balance sheet. The account in question is charged with actual payments made to retired employees and, in theory at least, credited each year with the amount necessary to produce a credit balance adequate to provide for all future pension payments to both presently employed, and already retired, employees. The use of this account as just described may, for convenience, be called the "actuarial" method.

An alternative method is not to set up a liability reserve at all, but simply to charge the actual pension payments, as made, against current revenue. This is the "pay-as-you-go" method. It eliminates the difficult actuarial problem of trying to estimate future liability for pensions, which liability it has been pointed out, may even equal or exceed the net worth of many companies! On the other hand, the pay-as-you-go method obscures, at least in the initial stages, an accumulating future liability from year

to year and this, as we know, can be a serious matter. In any case the operating results of a company on a "pay-as-you-go" basis would not be comparable with those of a company which does attempt to provide for its estimated future liability for pensions. Furthermore, the terms of the contract between the company and the labour union may in effect dictate the accounting treatment and require the actuarial method as a means of improving the chances that the company will have the cash to make the payments required.

Apart from the accounting problems involved, the advantages and disadvantages for society as a whole of a widespread adoption of pension plans have been much discussed. Most of the plans now adopted require contribution by the employer only (and none by the employee) and the employee can only realize his pension by remaining with the company in question until he retires. This, it is urged, may add to the immobility of labour since no one will wish to leave a job and forfeit the portion of pension which has accrued in his favour; it may mean that people are not as likely to find by trial and error the work for which they are best suited. On the other hand employers may tend to retain their workers, perhaps in a less strenuous capacity, until they are older as a means of getting work out of them which would not be forthcoming were they retired earlier on pension.

For a fuller discussion of most of the points mentioned above, we refer our readers to two articles: "Pension Plans from an Accountant's Point of View" by P. F. Brundage in *The Journal of Accountancy* for January 1950 and "The Labour Unions' Campaign for Pensions" by C. H. Curtis in *The Canadian Banker* (Spring 1950).

\* \* \*

The description of pension plans as "contributory" or "non-contributory", depending upon whether the employee is subject to a wage deduction in respect of the plan, is no doubt justified as a matter of convenience; but it strikes us it may not be a realistic classification from a long run point of view. We think that in periods when the labour supply is adequate the employee may well "contribute" anyway through having to accept a wage which is lower by virtue of the fact that a pension will be forthcoming upon retirement.

During the labour dispute which preceded the granting of pensions by U.S. steel companies last year, a Presidential Steel Fact Finding Board was appointed. In its report the Board found that pensions "should be considered a part of normal business cost to take care of permanent and temporary depreciation in human 'material' in much the same way as provision is made for depreciation . . . of plant and machinery." In an editorial *The Journal of Accountancy* (December 1949) has lashed out against this pronouncement: "Every accountant knows that depreciation is simply a periodic charge-off of a cost previously incurred, spreading the cost systematically over the useful life of the asset. If the quoted analogy were valid, the 'human material' would have to be bought outright initially and the cost charged off against current revenues over the useful life of the 'material'. This is absurd on the face of it."

### PUZZLE

A son, short of cash, telegraphed to his father:

SE.ND  
MO.RE  
-----  
MON.EY

The father was left to figure out how much to send. The problem above is in the form of an addition, each letter representing a numeral (from 1 to 9 and 0).

(Contributed by

Mr. J. K. Gibson, Toronto)

### ANSWER TO LAST MONTH'S PUZZLE

The three thieves stole 79 bananas. During the night the first thief took 26 bananas for himself and also gave one to the monkey, so that 52 bananas remained. Later, the second thief removed 17 of the 52 bananas as his share and gave another to the monkey so that 34 bananas remained.

Still later, the third thief removed 11 of the 34 bananas as his share and gave another to the monkey so that 22 bananas remained.

In the morning the 22 bananas were divided 7 to each thief and one to the monkey.

## CORRESPONDENCE

*Toronto, Ontario*

Sir: "A candidate who was a registered student-in-accounts for six months prior to service of at least six months in the armed services during the period 1939-1945 is exempt from writing Economics" (Ontario Institute rule regarding examinations).

This is the first time I have heard the proposition that service in the armed forces gives a basic training in economics, although I have been told that certain members of the forces did a land-office business in foreign currencies while serving in the European theatre of war. I should have thought that

the acquisition of these currencies and their subsequent conversion to assets in Canada is hardly the type of economics which would be particularly useful in the practice of a chartered accountant. I assume, however, that the lesson learned is thought to be of value and that the point of the exemption is that there would be considerable difficulty encountered in finding an examiner with better experience than these candidates.

*A "B. Com." who "managed" to get 50 marks in his C.A. Economics paper some years ago*

## PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect of course the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

## PROBLEM 1

Intermediate Examination, October 1949

*Accounting II, Question 4 (12 marks)*

Hoarse, Sope and Opra are partners in a radio business. There are three stores, each under the management of one of the partners, and in addition, Opra manages a service department which handles only the work of the three stores.

The profits of each store are separately calculated and are charged with interest at 6% per annum on capital employed. Interest is credited to the general pool. In addition to interest, the service department is charged with a salary of \$1,200 per annum for Opra's supervision which is credited to his store.

After interest and salary have been charged, the profit (or loss) of the service department is allocable to the stores in proportion to their respective shares in the turnover of this department.

After taking into account the transfer from the service department, the profit or loss of each store is divided: 90% to the individual partner in charge of the store, and 10% to a general pool.

The general pool is divided: Hoarse 1/2, Sope 1/3, and Opra 1/6.

For the year ending 30 June 1949, the following information is given:

Profit of service department before interest and salary ..... \$ 2,400

Turnover of stores with service department:

Hoarse .....	13,500
Sope .....	10,000
Opra .....	6,500

Profits of stores before interest:

Hoarse .....	19,000
Sope .....	16,000
Opra .....	11,980

## Capital employed:

Hoarse Store .....	42,000
Sope Store .....	27,000
Opra Store .....	18,000
Service Department .....	9,000

## Required:

Show allocation of profit for year ending 30 June 1949.

Note: Carry all computations to the nearest dollar.

## A SOLUTION

## HOARSE, SOPE AND OPRA

## ALLOCATION OF PROFIT

for year ended 30 June 1949

	Service	General Pool	Hoarse	Sope	Opra
Profit for year .....	\$ 2,400	\$ —	\$19,000	\$16,000	\$11,980
Service — salary .....	(1,200)				1,200
Interest — 6% of capital employed .....	( 540)	5,760	(2,520)	(1,620)	(1,080)
Distribution of service profit ...	( 660)		297	220	143
10% of profits to pool .....		4,361	(1,677)	(1,460)	(1,224)
Distribution of pool .....		(10,121)	5,060	3,374	1,687
Net profit for year .....	—	—	\$20,160	\$16,514	\$12,706

## PROBLEM 2

## Final Examination, October 1949

*Accounting III, Question 3 (15 marks)*

Lastin and Furstout operate a retail store as partners sharing profits and losses equally. The following is the statement of profit and loss for the year ending 31 Dec 1948:

Gross Profit on Trading .....	\$24,340
Discounts earned .....	1,400
Profit on sale of investments .....	200
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	\$25,940

## Less:

Staff salaries .....	\$ 6,000
Depreciation .....	4,100
Rent .....	1,800
Taxes .....	2,000
Repairs and improvements .....	3,000
Printing, postage and stationery .....	1,600
Pension fund contributions for employees under an approved scheme .....	360
Pension fund contributions—Lastin .....	390
“ “ “ —Furstout .....	270
Heat, light and water .....	1,700
Moving expenses due to non-renewal of expired lease .....	500

## Bad Debts:

Current year's debts written off .....	\$250
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Addition to reserve to bring to amount reasonably required	300	
	<u>\$550</u>	
Less bad debts recovered	170	380
Interest and exchange		100
Partners' salaries—Lastin		4,000
" " —Furstout		3,000
Interest on capital—Lastin		300
" " —Furstout		200
Donations:		
Y.M.C.A.	10	
Board of Trade	30	
Red Cross	50	90
	<u></u>	
Loss on sale of truck		300 30,090
Net Loss		<u>\$ 4,150</u>

Lastin, a married man with 2 children aged 12 and 17 living at home, has the following income in addition to that derived from the partnership:

Income from real estate	\$2,500
Interest on bonds	1,000

In January 1948 Lastin transferred to his wife (who has an annual income of \$450 from her father's estate) 4% interest-bearing bonds of a face value of \$10,000. Interest is payable on these bonds in June.

Lastin made charitable donations in his own name to the amount of \$350 during 1948.

Furstout is separated from his wife to whom he makes a monthly payment of \$50. He has 3 children, ages 10, 14 and 18 at home. His medical expenses for the year 1948 amounted to \$200. In addition to his income from the partnership, he received \$2,000 interest in 1948 on bonds.

Required:

- Lastin's taxable income.
- Furstout's taxable income.

In both cases, show how you arrived at your answer.

### A SOLUTION

Loss from partnership, per statement		\$4,150
Less expenses not allowed:		
Pension fund contributions — Lastin	\$ 390	
" " — Furstout	270	
Partner's salaries — Lastin	4,000	
" " — Furstout	3,000	
Interest on capital — Lastin	300	
" " — Furstout	200	
Donations	90	8,250
		<u>\$4,100</u>
Less profit on sale of investments		200
Profit before salaries and interest on capital		<u>\$3,900</u>

However, apparently, according to the agreement, Lastin is to receive salary of \$4,000, plus interest of \$300 on capital, and Furstout is to receive salary of \$3,000 and interest of \$200 on capital. Therefore, in distributing income of partnership it must be assumed that there is a loss of \$3,600 to be shared equally. (i.e. \$7,500 less \$3,900; taxable income — \$3,600) Then Lastin's share of partnership income is salary \$4,000, plus interest \$300, less  $\frac{1}{2}$  loss \$1,800, or \$2,500. Furstout's share of partnership income is salary \$3,000, plus interest \$200, less  $\frac{1}{2}$  loss \$1,800, or \$1,400.

## (a) LASTIN'S TAXABLE INCOME

Income from partnership .....			\$2,500
Income from real estate .....			2,500
Interest on bonds .....			1,000
Interest on bonds transferred to wife — deemed to be Lastin's .....			400
			<hr/>
			\$6,400
Less deductions:			
Charitable donations — $\frac{1}{2}$ partnership .....	\$ 45		
own name .....	350	395	
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			\$6,005
Less exemptions — as a married man .....	\$1,500		
less wife's income in excess of \$250 .....	200	\$1,300	
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children, 1 at \$100 and 1 at \$300 .....		400	1,700
			<hr/>
Lastin's taxable income .....			<u>\$4,305</u>

## (b) FURSTOUT'S TAXABLE INCOME

Income from partnership .....			\$1,400
Interest on bonds .....			2,000
			<hr/>
			\$3,400
Less separation allowance paid to wife — assuming written separation agreement .....			600
			<hr/>
			\$2,800
Less deductions:			
charitable donations — $\frac{1}{2}$ partnership .....	\$ 45		
medical expenses .....	\$ 200		
less 4% of net taxable income .....	112	88	133
			<hr/>
			\$2,667
Less exemptions as a married man .....	\$1,500		
children, 1 at \$100 and 1 at \$300 — one taken for exemption as married man .....	400		1,900
			<hr/>
Furstout's taxable income .....			<u>\$ 767</u>



## PROBLEM 3

Final Examination, October 1949

*Accounting III, Question 4 (15 marks)*

The following is the trading and profit and loss account of the By N. Cell Co. Ltd. for year ending 31 Dec 1948:

Sales .....			\$780,000
Inventory as at 1 Jan 1948 .....	\$ 33,000		
Purchases during year .....	358,000	\$391,000	
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Inventory as at 31 Dec 1948 .....	65,000		
Less reserve for future price decline .....	10,000	55,000	336,000
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Gross margin on sales .....			\$444,000
Less expenses:			
Salaries (as per T4 return) .....		\$ 49,000	
Rent .....		25,200	
Heat, light and water .....		2,500	
Interest on bonds .....		9,000	
Donations—Red Cross .....		1,700	
" —Boy Scouts .....		1,100	
" —Girl Guides .....		1,100	
Premium on life insurance of president .....		600	
Travelling .....		4,200	
Printing, postage and stationery .....		5,100	
Depreciation on cars and trucks .....		4,500	
Voluntary bonus not exceeding \$25 per person .....		400	
Dividends—preferred cumulative .....		9,000	
" —common .....		4,500	
Dues and subscriptions .....		9,000	
Advertising .....		21,000	
Legal—general .....		2,000	
" —prosecution .....		2,000	
Audit .....		2,000	
Fine paid under Wartime Prices and Trade Board .....		2,400	
Executive salaries as per T4 return .....		37,000	
Compensation to widow of employee killed on duty ....		3,000	
Annual allowance to retired employees .....		1,200	
Contributions to approved pension plan:			
Annual contribution .....	\$ 4,000		
Lump sum payment in respect of past service .....	29,000	33,000	
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Repairs .....		10,400	
Goodwill written off .....		6,000	
Loss on sale of securities .....		2,700	
Provision for bad debts .....		3,200	
Provision for contingencies .....		15,000	
Loss of subsidiary company .....		6,000	273,800
		<hr/>	
			\$170,200

Add sundry income:

Rent from sub lease .....	2,400	
Dividends received from Canadian companies .....	5,700	
Interest on Dom. of Can. Bonds .....	3,000	
Profit on sale of car .....	600	11,700

Net profit for the year .....		<u>\$181,900</u>
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Required:

A reconciliation of the 1948 taxable income of the By N. Cell Co. Ltd. with the net profit for the year as recorded.

**A SOLUTION**  
**BY N. CELL CO. LTD.**

**TAXABLE INCOME**  
**for year ending 31 Dec 1948**

Net profit for year per statement .....		\$181,900
Add expenses not allowed:		
Inventory reserve .....	\$ 10,000	
Premium on life insurance .....	600	
Voluntary bonus .....	400	
Dividends—preferred .....	9,000	
"      —common .....	4,500	
Legal—prosecution—costs of defending action, probably the one resulting in fine under the Wartime Prices & Trade Board not allowable .....	2,000	
Fine .....	2,400	
*Lump sum pension payment for part services .....	26,100	
Goodwill written off .....	6,000	
Loss on sale of securities .....	2,700	
Provision for contingencies .....	15,000	
Loss of subsidiary company .....	6,000	84,700
		<u>\$266,600</u>
Deduct:		
Dividends .....		5,700
Taxable income .....		<u>\$260,900</u>

\* Pension—90% of lump sum payment to be claimed in following 9 years

**PROBLEM 4**

**Final Examination, October 1949**

*Accounting III, Question 5 (9 marks)*

Explain briefly how each of the following items would be dealt with in determining the taxable income of the recipient:

- (a) Stock dividend of 3% declared to shareholders of XYZ Co. Ltd. received by J. Smith.
- (b) Stock dividend of 3% declared to shareholders of XYZ Co. Ltd. received by Jones Co. Ltd.

- (c) 50 shares of common stock of XYZ Co. Ltd., par value \$100, received by J. Brown in consideration for invoice of \$4,700 for plumbing services rendered.
- (d) Winding up dividend of \$60 received by W. Wrong in settlement of account of \$100 owing to him by bankrupt company.
- (e) Winding up dividend of \$120 received by D. Right in respect of his shares of par value of \$100.
- (f) Premium on redemption of preferred shares received by F. N. Guy.

### A SOLUTION

- (a) Dividends are income in hands of recipient to the extent of the recipient's proportionate share of surplus capitalized.
  - (b) As in (a) except that limited companies do not pay tax on dividends received from other Canadian companies paying tax under the Act.
  - (c) Brown would treat 50 shares as being worth \$4,700, payment for services, unless he could establish a lower value was attributable to the shares.
  - (d) The \$60 would go to reduce the amount of the account receivable outstanding and the remaining \$40 would be written off as a bad debt and would enter into the determination of income. However, if the debt had been previously written off by W. Wrong, the \$60 dividend would be treated as income.
  - (e) The proportion of the \$120 that was Right's share in the undistributed income of the company, for tax purposes, would be regarded as income in Right's hands.
  - (f) The premium would be regarded as income of F. Guy.
- In (a) and (e) the 1949 amendments make provision for reduction in tax payable of 10% of the dividends received on the junior shares of a company.

### PROFESSOR PATON ON CONSERVATISM IN ACCOUNTING

"... and when an accountant has no real argument to advance that's always his last word: 'It isn't conservative'. That's a term we've been using for years to squelch upstarts who make any suggestion to the effect that there are some serious limitations in the accounting process as conventionally handled. Most of the folks that throw this word at you don't even know what they mean by it. It has become a mystic phrase, useful for the purpose of stopping all discussion. In view of the statements I have made elsewhere on this subject it is hardly necessary for me to say here that I consider the brandishing of this term as a means of settling accounting questions very silly. I am all for stressing competence, carefulness, integrity, good judgment, and so on in the field of accounting, but I certainly wish that we would abandon reliance on 'conservatism'. If conservatism means — as it generally seems to — minimizing, scaling down, subtracting, it obviously has no force as a standard or basic consideration to which to refer accounting problems."

—W. A. PATON in *The Journal of Accountancy*, January 1950

